Compliments of The First National Bank in Minneapolis, Minn.
Correspondent of The National City Bank of New York

1812

1929

Economic Conditions
Governmental Finance
United States Securities

New York, February, 1929

General Business Conditions

TRADE and industry in the month of January have recovered quickly to a high level of activity, strengthening the general belief in the continuance of good business through the first half of the year, at least. There is dissatisfaction with the money situation, which is discussed at length in later paragraphs, but aside from the misgivings which it occasions confidence prevails.

The steel industry has started off at an active pace, mill operations averaging 84 per cent of capacity throughout January as against 70 to 80 per cent in January a year ago.

The automobile industry is swinging back into its stride after the December lull, and with the annual shows out of the way plants are speeding production in preparation for what is expected to be the largest Spring business on record. Looking towards the attainment of its reported goal of a 2,000,000 car output for 1929, the Ford Motor Company on December 30 announced its intention of returning to the six-day manufacturing week, at the same time retaining the five-day week for the individual worker, a policy necessitating the addition of 30,000 workers to its already record payrolls. In general, employment at automobile centers is larger than in any previous January.

Hesitancy in Building

In contrast with the activity in the automobile industry, the building industry is showing signs of some hesitancy, presumably the effect of high money rates. After barely exceeding the total of the previous year in November, the value of contracts awarded throughout the country during December, as reported by the F. W. Dodge Corporation, fell 9 per cent under those of December, 1927, while the report of work contemplated but not yet under contract indicated a decrease of 27 per cent as compared with the same month a year previous. For the first three weeks of January, moreover, the figures of contracts awarded continued to run somewhat under those of the previous year.

Coming after a year of record breaking construction work, and at a time of relatively unfavorable credit conditions, these indications of a decline in building assume more than an ordinary significance.

Dependent as the building industry is upon the mortgage and bond market it is remarkable that construction operations have held up so long in the face of tightening money conditions. If building is now feeling the effects of a drying up of available funds, it is partly at least because methods of building financing are not evolving with the trend of public preference for securities carrying a proprietary interest in the future profits of the undertaking. In this period of depression in the market for fixed income securities, general industry is finding it possible to raise new capital on favorable terms through the issuance of stock or of bonds carrying privileges of conversion into stock. These examples from the field of general business point the way to a solution of the problem facing building. If this industry can conform to the public trend, providing on a sound basis the type of security the public wants, there seems no reason why it should lack for ample funds with which to go ahead to the realization of another year of large volume operations.

Agriculture, Manufacturing and Trade

Aside from these indications of less active building, the general business situation presents a favorable picture. Commodity prices, despite the marked expansion of business last year, show no evidences of inflation. In fact, the index of the Department of Labor in December of 1928 was slightly lower than in December of the previous year.

All the principal farm products are now on a good price basis. Wheat at Chicago in the past month has touched $1.26¾ per bushel for the March delivery, which is up 20 cents per bushel from the low price on the crop, $1.06¾ for September, which is better than seemed possible last Fall when the big world crop first came into view. Moreover, the new crops of Argentina and Australia are larger than

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were then counted on. The explanations are (1) supplies have been disappearing rapidly, indicating a good rate of consumption abroad, and (2) some apprehension exists as to the condition of the winter wheat crop of this country, owing to freezing weather in the middle west with little or no snow covering. The encouraging thing is the way the price has recovered despite what is perhaps the largest world's crop ever produced.

Corn is slightly under the dollar mark in Chicago, which is about 10 cents above the price one year ago. Oats are about the same as a year ago.

Cotton has lost a little in price in the past month, to about 19½ cents, but this seems to be due to a decline of speculative interest rather than to adverse developments in the situation. It is quite certain that world consumption of American cotton in the current year will exceed the 1928 crop, thus making further inroads on the carry-over stock. This is a fundamentally favorable situation.

The final figures upon the 1928 crops by the Department of Agriculture estimate the aggregate value of the grown crops at $8,456,000,000, which compares with $8,522,000,000 in 1927. This, however, does not include live stock or animal products, and if they were included the results undoubtedly would be larger in 1928 than in 1927, as the live stock and dairy industries have had on the whole a more favorable year than the one preceding.

Retail trade, as usual at this season, has had to contend with bad weather in many localities, and this year the influenza epidemic has been an added handicap, but in general business appears to have been fairly good and it is believed that final January figures will show an improvement over a year ago in most cases.

Comparison of the results achieved by the different types of stores reveals striking contrasts which are indicative of changes going on in merchandising methods. Chain store and mail order houses entering the chain store field continue to show large gains, ranging up to 30 per cent or more. Department store sales throughout the country, on the other hand, gained only 1 per cent in December over December a year ago, with much spottiness in evidence, according to reports to the Federal Reserve Board. The fact that December had one less business day this year accounts in part for the smaller increase, but even so the showing is far behind that of the chain stores. As to the thousands of small retailers, whose figures are not available, it is known that many are being hard pressed by the competition of the larger organizations.

Output in the New England shoe industry has been stepped up sharply in recent weeks, and there is more confidence in the textile situation. Actual business in cotton goods has been somewhat slow in developing since the first of the year, but in the silk industry expectations are high for a big Spring. Rayon continues to forge ahead, with prospects of new high records of production and consumption during the year.

The copper market continues strong, with prices up an additional ¼ cent in January to 17 cents, the highest in five years. The steady decline in reserve stocks of refined metal was halted in November and December when the totals increased 6,600 and 13,300 tons respectively to 65,500 tons. Even so, the total is still far below normal, now estimated at approximately 100,000 tons. Moreover, as January shipments have been exceptionally heavy it is thought that some new inroads may have been made upon the meagre stocks during the month.

The oil situation is disturbing, as production is once more showing a tendency to get out of hand. After having been kept in check for over a year by restriction agreements, production has been climbing gradually to new high levels, reaching in the week of January 26 a daily average of 2,663,100 barrels, according to the American Petroleum Institute, or considerably above the level prevailing in the Summer of 1927 when overproduction caused alarm and resulted in the adoption of restrictive measures. Though a laudable attempt to cure a badly demoralized condition, the oil curtailment plan appears in danger of breaking down, partly on the usual difficulty besetting programs of price stabilization through curtailment of production,—namely, inability to control enough of the industry to make restriction effective. In oil, as was recently the case in rubber and sugar, the first fruits of restriction were apparently beneficial. As in these other lines, however, the improvement in market conditions resulting therefrom has apparently stimulated independent activity to the point where it threatens to nullify the efforts of those voluntarily sacrificing a part of their production. Joseph E. Pogue, consulting engineer and oil expert, in a recent article, describes the results of the oil curtailment program as follows:

> In fact, it may be queried whether the restriction of current production, with the price improvement and optimism engendered thereby, has not actually stimulated new discoveries and thus prolonged and intensified the period of overproduction. It is worthy of note that recent months have witnessed one of the most successful wildcat campaigns in the entire history of the oil business, and in consequence the industry must cope with a larger potential production by far in 1929 than was the case in 1928. In this respect the oil industry has lost ground instead of making headway.

During January prices of mid-continent crude and California heavy oils underwent reductions. Gasoline prices showed the usual seasonal decreases.

In the newsprint paper industry, which has also been suffering from overproduction, efforts to effect a cure are reported to have taken the form of an agreement by the principal Canadian producers to stabilize prices for 1929 at $55 a ton. This follows an earlier agreement reached last November to keep production in Canada down to 80 per cent of capacity.

Foreign Trade

The foreign trade situation continues satisfactory, merchandise exports for the calendar year 1928 totaling $5,129,132,000, the highest since 1920 when the level of prices was much above that of today. Imports totaled $4,089,930,000, but, owing chiefly to lower prices ruling for such commodities as sugar, rubber, silk, and newsprint paper, failed to measure up fully to the levels of the years immediately preceding. As a consequence, the balance of exports increased by more than $350,000,000 over that of 1927, to $1,039,202,000, and was the largest since 1921.

Thus the United States continues to roll up large export balances despite its position as a creditor nation. For this the explanation lies in the huge annual investments of the United States in foreign countries and the expenditures of American tourists abroad which in the year 1928 were estimated as high as $900,000,000. How the decline in foreign security offerings in this market which has followed upon the tightening of money will affect our international balance sheet during the current year is an interesting question, but it would seem as though the logical outcome of present tendencies, if persisted in, must be a revival of gold imports, or, if obstacles are placed in the way of these, a reduction in our trade balance.

Of as much significance as the totals of our export trade is the growing proportion shown of manufactured goods. Taking the classified figures for 1928, it will be seen that of total domestic exports of $5,029,000,000, manufactured or semi-manufactured goods accounted for $3,443,000,000, or 69 per cent. Moreover, the amount has been growing every year, indicating an increasing ability on the part of American manufacturers to hold their own in foreign markets. This should be comforting to those who are inclined to fear the consequences of foreign competition upon our industries.

The Gain in Railway Traffic

Reflecting the larger movement of domestic and export freight, railway traffic has continued into 1929 the improvement begun in the latter part of 1928, and car loadings for the first three weeks of January exceeded those in the corresponding period of last year by 4 per cent. Coal loadings showed the largest gain with an increase of 12 per cent, followed by smaller increases in shipments of coke, ore, and "miscellaneous" products. Grain shipments showed practically no change while loadings of forest products, livestock, and merchandise and less-than-carlot freight fell behind.

With an improving traffic volume, railway earnings have taken a sharp upturn. November, with a net operating income for Class I railways of $113,694,856, ran 31 per cent ahead of November, 1927, and fell just short of the total for November 1926 which was the best for that month since the passage of the Transportation Act. December promises to make an even better showing, 67 railroads that have thus far reported recording a gain of 65 per cent over December 1927.

One effect already of the more favorable turn in railway fortunes has been an increase in the orders for railway equipment, and manufacturers in that line are hopeful of a larger business as the year advances. Should this materialize it would be an important bullish influence on general business.

Forecasts of railway traffic continue optimistic, as shown by the estimates of the Shippers Regional Advisory Boards which place the probable freight car requirements for the first quarter of this year 4.9 per cent greater than in the first quarter of last year. Following is a table comparing the estimates for the first quarter of this year with actual shipments for the first quarter of 1928 for twenty-nine principal commodities, the changes being gains except as noted:

Commodity	Estimated Carloadings 1st Quarter 1929	Actual Carloadings 1st Quarter 1928	% Increase
Grain, all	409,414	413,544	— 1.0
Flour, meal & other mill products	241,410	226,602	6.5
Hay, straw and alfalfa	81,097	81,361	— .3
Cotton	62,847	54,984	14.3
Cotton seed & products, except oil	53,317	45,147	18.1
Citrus fruits	37,006	27,933	32.5
Other fresh fruits	38,895	31,159	24.8
Potatoes	65,448	69,738	— 6.2
Other fresh vegetables	55,154	61,140	— 9.8
Live stock	406,451	402,876	.9
Poultry and dairy products	31,111	30,968	.5
Coal and coke	2,953,917	2,805,808	5.3
Ore and concentrates	135,584	130,770	3.7
Gravel, sand and stone	471,916	454,286	3.9
Salt	22,969	22,332	2.9
Lumber and forest products	917,951	891,984	2.9
Petroleum & petroleum products	492,396	468,081	5.2
Sugar, syrup, glucose & molasses	67,625	63,991	5.7
Iron and steel	442,844	420,199	5.4
Machinery and boilers	49,912	45,832	8.9
Cement	122,684	119,401	2.7
Brick and clay products	137,473	133,140	3.3
Lime and plaster	53,457	52,267	2.3
Agricultural implements & vehicles other than automobiles	31,418	28,923	8.6
Automobiles, trucks and parts	300,622	234,600	28.1
Fertilizers, all kinds	177,532	177,521	....
Paper, paperboard and prepared roofing	102,872	98,253	4.7
Chemicals and explosives	46,087	42,308	8.9
Canned goods	38,666	39,358	— 1.8
Total all commodities listed	8,048,075	7,674,506	4.9

Money and Banking

The month of January always is a month of relaxation in business activities, and of easing tendencies in the money market. It is settlement time throughout the country. Inventories are low, collections are being made, cash funds accumulate, bank loans are paid, and the decks are cleared for the new business year.

This year unusual interest has been felt in this seasonal liquidation, on account of the extraordinary absorption of funds in the stock market during the last year, and the abnormal conditions in the money market resulting therefrom. During the Fall months, borrowers on stock exchange collateral while paying high rates consoled themselves with the belief that after the end of the year money would be plentiful and easy; member banks looked forward hopefully to the prospect of reducing their rediscounts at the Reserve banks, and the latter looked forward to the opportunity of recovering control over the additional supplies of credit which they were releasing to meet the demands of crop-moving and trade. It remained to be seen to what extent these various and somewhat conflicting expectations would be realized.

The table below, which compares the principal items of condition of the Reserve banks by weeks from December 26 to January 23 and on January 25, 1928, will show the outcome.

It will be seen that all parties named had their expectations realized to some extent. Federal Reserve notes in circulation decreased by $249,000,000 from December 26 to January 23, reflecting the retirement of currency from circulation on completion of the holiday trade. Other forms of currency were retired in like manner, and in the aggregate, currency retirement has been the largest single factor in the reduction of Reserve credit, the flow back to the member banks aiding them to reduce their indebtedness at the Reserve banks. The total reduction of outstanding Reserve credit was $452,000,000, of which $385,000,000 was in rediscounts and advances, $35,000,000 was in bills of open market purchase, and $30,000,000 in holdings of Government securities.

Reflecting these substantial reductions in the amount of their credit outstanding, the ratio of reserves to liabilities of the Reserve banks rose sharply from 61.6 per cent on December 26 to 69.3 per cent on January 23. These figures are from the consolidated statement of the twelve banks, but the effect of the liquidation was concentrated largely in the New York bank, which on the 23rd ultimo had a reserve of 80 per cent, while the other eleven ranged from 55.2 per cent in the Boston and Dallas institutions to 69.2 per cent in Philadelphia.

Gold reserves increased by $64,000,000, the result of the return of gold paid into circulation during the holiday season.

Member bank reserve deposits declined by $50,000,000 from December 26 and by $135,000,000 from January 2, due to the use of reserves to pay off rediscounts when the peak of the demand for credit was over.

As the member banks paid off or reduced their borrowings at the Reserve banks, money naturally eased, and the call loan rates declined from the high December figures to what seemed by comparison the low figure of 6 per cent.

This is the extent of the January easement in the money market. Judging from some of the comment, one might have thought that a fundamental change had occurred in the credit situation whereby money was henceforward to become plentiful and high rates a thing of the past. Yet liquidation always occurs in January, and after that, if business follows its normal course, the demand for money increases, money tends to flow out from the centers and rates to stiffen. Hence we may assume that the period of liquidation is practically over.

Comparisons with Last Year

Comparing the figures of the table for January 23 this year and January 25 last year, every item indicates lower reserve resources. Notes in circulation are higher by $76,000,000, gold reserves are lower by $171,000,000, bills discounted for member banks are higher by nearly $400,000,000, bills bought in the open market are higher by $107,000,000, and the reserve in

FEDERAL RESERVE BANKS
PRINCIPAL ITEMS OF CONDITION
(000,000 omitted)

	Rediscounts and Advances	Bills Bought in Open Market	U. S. Securities Held	Total Bills and Securities	Member Bank Reserve Deposits	Federal Reserve Notes in Circulation	Gold Reserve	Ratio of Reserves to Note and Deposit Liabilities Combined
Dec. 26, 1928	1,167	489	232	1,899	2,409	1,910	2,584	61.6
Jan. 2, 1929	1,151	484	244	1,890	2,494	1,829	2,588	61.9
Jan. 9, 1929	876	477	239	1,602	2,405	1,745	2,632	66.3
Jan. 16, 1929	822	481	238	1,551	2,415	1,697	2,630	67.0
Jan. 23, 1929	782	454	202	1,447	2,359	1,661	2,648	69.3
Jan. 25, 1928	385	347	441	1,174	2,355	1,585	2,819	75.0

the form of United States securities is lower by $239,000,000.

The status of member banks throughout the country as compared with this time last year and two years ago, may be judged by the following figures for the member banks reporting weekly, which include approximately 65 per cent of all member bank assets and 40 per cent of all bank assets:

STATISTICS OF WEEKLY REPORTING MEMBER BANKS
(Corrected to conform to latest reports)

	1929 January 23	1928 January 25	1927 January 26
Total Loans	$16,062,000,000	$15,232,000,000	$14,374,000,000
Loans on securities	7,352,000,000	6,556,000,000	5,699,000,000
All other loans	8,710,000,000	8,676,000,000	8,675,000,000
U. S. Government investments	3,116,000,000	3,021,000,000	2,366,000,000
Other securities	2,954,000,000	3,095,000,000	2,801,000,000
Total investments	6,070,000,000	6,116,000,000	5,167,000,000
Total loans and investments	22,132,000,000	21,348,000,000	19,541,000,000
Net demand deposits	13,366,000,000	13,749,000,000	12,867,000,000
Time deposits	6,885,000,000	6,587,000,000	5,858,000,000
Government deposits	83,000,000	81,000,000	120,000,000
Total deposits	20,334,000,000	20,417,000,000	18,845,000,000

These figures are worthy of examination and comparison with the Reserve figures appearing above, for January 25, 1928, and January 23, 1929. They show the relatively small amount of Reserve credit outstanding one year ago, notwithstanding the great increase of member bank credit in the preceding year and previous years, and the changes which have resulted from the reversal of the gold movement since the latter part of 1927.

It will be seen that the total loans of these banks are up $830,000,000 from one year ago and $1,688,000,000 from two years ago, of which in the one year $796,000,000, and in the two years, $1,653,000,000, was in loans on securities. All other loans are only $34,000,000 higher in 1929 than in 1928 and $35,000,000 higher than in 1927.

Investments are down $46,000,000 from one year ago, which compares with an increase of $949,000,000 in the preceding year.

Total deposits increased $1,572,000,000 from 1927 to 1928, and then made an actual decline to 1929, an extraordinary circumstance in the history of American banking, especially in view of the fact that it occurred in a year of general business prosperity and expanding bank credit. The explanation, of course, is found in the loss of bank deposits for loans at the stock exchange for account of bank depositors. Net demand deposits have decreased in the past year by $383,000,000 whereas in the previous year they increased by $882,000,000, but time deposits have continued to increase, although at a greatly diminished rate.

The explanation of the fact that bank loans show a large increase despite the decline of deposits is found in the aid given by the Federal Reserve banks, whose total bills and securities are $273,000,000 higher than one year ago. This amount of Reserve credit has meant a much greater increase of lending power to the members.

Money Rates in January

With the member banks still indebted to the Reserve banks in an aggregate amount approximately $400,000,000 larger than one year ago, and larger than at this time in any year since 1921, it is not surprising that money rates have remained high.

Call money, which responds to the daily fluctuations in supply, declined sharply after the turn of the year, from the maximum of 12 per cent, but at 6 per cent was still the highest prevailing rate for January since 1921, and compared with 3½ to 4 per cent in January a year ago. Moreover, how slender has been the margin of surplus was shown by the rapidity with which the rate advanced to 9 per cent at the middle of the month and to 7 and 8 per cent at the month-end, when the demand for funds increased somewhat above the ordinary.

The most significant feature of the market has been the practically unchanging level of rates for time money on collateral security, at 7½ to 7¾ per cent for all maturities. The stability of this rate indicates the lender's opinion of the outlook for money.

The member banks generally have maintained the policy of holding money for industrial and commercial purposes at a level only slightly above the Reserve discount rate, but this level must be considered an artificially low one under the circumstances. As a result the banks, instead of having a normal growth of deposits in the last year actually have lost deposits and become a diminishing factor in the money market. Doubts therefore arise as to their ability to maintain the differential between collateral and commercial loans.

The Brokers' Loan Situation

The increasing volume of loans at the stock market made by and for account of lenders other than the New York banks, and in yet greater volume for the account of lenders outside of the country and outside the banking business, has been a subject of discussion throughout the past year, and one of growing importance. It is perhaps not strange that at first the popular idea should be that nobody was concerned in the situation but the New York banks, and they only because they were losing deposits and profits; but a credit situation of such magnitude as the call money market has assumed, and of such known instability, is a situation of great general importance.

The aggregate amount of brokers' loans at the first of each month from February, 1928,

to January, 1929, as made public by the New York Stock Exchange, has been as follows:

STOCK EXCHANGE REPORT
OF BROKERS' LOANS

1928		1928	
February	$4,420,352,541	August	$4,837,347,579
March	4,322,578,914	September	5,051,437,405
April	4,640,174,172	October	5,513,639,685
May	4,807,782,590	November	5,879,721,062
June	5,274,046,281	December	6,391,644,264
July	4,898,351,487	January, 1929	6,439,740,511

This report which includes all borrowings by members of the Exchange, shows an increase of a little more than $2,000,000,000 in the period. Of the total on February 1, 1928, 76.8 per cent was on call and 23.2 per cent on time; January 1, 1929, 88.9 per cent was on call and 11.1 per cent on time.

The New York City members of the Federal Reserve Bank of New York report weekly the amount of their loans to brokers, classifying them into loans on own account, loans for out-of-town banks and loans for others. These loans of course are included in the total reported by the Stock Exchange, but are of special interest because of the classification. We give the figures for the first and last reports in 1928 and the reports of January 2 and 30, 1929:

FEDERAL RESERVE REPORT
OF BROKERS' LOANS
(000,000 omitted)

	Jan. 30, 1929	Jan. 2, 1929	Dec. 26, 1928	Jan. 4, 1928
For own account	$1,091	$1,516	$1,109	$1,511
For out-of-town banks	1,853	1,648	1,660	1,371
For others	2,615	2,166	2,322	928
Total	$5,559	$5,330	$5,091	$3,810

These loans to brokers of course by no means represent the total of loans on stock exchange securities. There are large borrowings by holders direct from their own bankers, which we refer to only as indicating the ramifications of the market influence.

Also there are security exchanges of varying importance in many cities, which are the center of trading in local securities, and anything that may be called a convulsion upon the New York exchange has reactions upon them all, for in time of pressure holders usually sell whatever they can sell to the best advantage to protect other holdings.

Interest, however, centers in the brokers' loans for the account of "others," as reported by the New York members of the Reserve system, which show an increase from $928,000,000 January 4, 1928, to $2,615,000,000, on January 30, 1929, or the sum of $1,687,000,000. These figures, however, do not represent the total of loans of this character, for it is known that an important part of the loans made for "out-of-town banks" are loans which these banks have had made at the request of their depositors. It is probable that the increase shown for out-of-town banks is largely if not wholly of this character.

The table of member bank brokers' loans given above shows a decline of approximately $500,000,000 in loans for own account from January 4, 1928 to January 30, 1929, while the total increased by about $1,700,000,000. That is to say, the share of the New York member banks decreased from about 40 per cent to 19.6 per cent. On the other hand, loans for "others" have increased from 24 per cent to 47 per cent.

Loans for Others

The New York bankers have noted the changing situation with concern and have frankly expressed themselves about it. They know from experience that they cannot be indifferent to conditions in the call loan market, even if their own commitments there are comparatively small. Every banker finds it important to take account of his contingent liabilities—that is, of all conditions which may create demands upon him—and the New York bankers know the vicissitudes of the call money market. They know that in an emergency that market and the entire stock exchange entourage will be on their door step begging for help and they cannot view with indifference the growth of dangerous possibilities with which they feel they might be unable to deal.

The similarity often suggested between call loans on stock exchange collateral and bank deposits exists in only limited degree. As a rule, the relationship between a bank and its patrons is much more interdependent and permanent than the relationship between lenders and borrowers in the call market. The latter is one of the lightest and most easily severed relationships known to the business world. And yet it is true that the banking business itself was subject to disastrous convulsions from time to time, so long as it was without the organization for protection finally developed in the Federal Reserve system.

The call money market is supplied with funds by thousands of scattered lenders, who are without contacts either with each other or the borrowers, and upon collateral which, whatever its ultimate value may be, is dependent for price stability upon a stable volume of loans, and there are no reserve resources but such as the New York banks may voluntarily furnish. No great body of credit, payable on demand, is safe without reserves of some kind, and there is room for question as to the degree of unanimity which the New York banks may manifest in an emergency.

An examination of the above classified table of brokers' loans shows some suggestive changes in the week from December 26 to January 2. The year-end settlements require considerable shifting of funds. It is the pinch

of the year, and in this week, with money touching 12 per cent, loans for Others and Out-of-town banks declined by $168,000,000, while those for the New York banks rose by $407,000,000.

This illustrates the importance of the reserve resources which the call loan market does not have, and in this instance the element of alarm was not present. It was obviously a temporary situation, the amount comparatively small, and the New York banks handled it by borrowing at the Reserve bank. It is evident, however, that if confidence was disturbed no sort of cooperation could be had among the multitude of lenders in the call market, and that nothing could be expected of them but that they would look to the safety of their individual interests.

Threatening Effects Upon the Business Situation

It is not difficult to see that in more ways than one general business may be affected by this unusual credit situation. The rise of loans for Others to the new high point of January 30 indicates a possibility that their volume may continue to increase unless lenders of this class come to a better appreciation of the possible results of the practice in which they are joining. Apparently the practice is spreading. It is receiving much publicity, and it is difficult to say how far it may extend under the inducement of attractive interest rates. The treasurers of corporations and other business men who are making these loans have no thought but that they are following a perfectly proper course in using their funds as seems for the moment most advantageous for the interests which they represent, but every one of them would be quick to agree that he was more interested in the maintenance of general prosperity than in obtaining the interest differential which the stock market imagines itself able to pay over the rates which the banks are endeavoring to maintain for industry and trade.

Let an example be supposed of a corporation with working assets of, say, $25,000,000, and having as the result of forehanded financial policy free funds to the extent of say $3,000,000, available for short loans in some form. Let it be supposed that with a general state of prosperity this corporation is able by working to capacity to earn 10 per cent upon its working assets, or $2,500,000, and that by lending at call it may earn an excess of 2½ per cent on the $3,000,000 over the rate it might obtain on time loans, i.e., acceptances or other commercial paper lending support to industry. Here is a possible $75,000 gain by participation in a practice which if it becomes sufficiently general will imperil the $2,500,000. Unquestionably the interest of this corporation is in supporting the general industrial situation, and having its own industry active to the degree that affords the highest yield of net earnings.

There can be no disagreement over the proposition that the managers of our corporations and of all business are interested primarily in stability of financial and industrial conditions. The practice of diverting money from the banking system, which is the common reservoir of funds from which business is supplied, to a fund which is devoted only to stock market purposes, is disadvantageous to general business. It is lessening the supply of funds available for regular business purposes, and for which business is given a preference, and making it more difficult for the banks to continue the policy of affording an ample supply at rates which to some extent are independent of rates ruling for brokers' loans. The existing low rates cannot be maintained unless the supply of bank funds is maintained.

It should be clearly understood that the objection to corporation lending in the call market is not simply or chiefly on account of the depletion of bank deposits, or against the lending of surplus funds in the money market, but on account of the withdrawal of these funds from the supply available for general business purposes. If short loans are made for industrial or commercial purposes the same objection does not lie, but industry and trade does not look to the call market to finance their operations.

And finally a practice which reduces the supply of bank funds and creates an outside supply of such proportions, especially available for speculative operations, tends to nullify all the safeguards which experience and legislation have provided for the banking business in the past. There is no regulation of brokers' loans or the call loan market, nor is it probable that any can be devised that will not be disadvantageous. There is danger even in the probability that regulation will be attempted.

The Federal Reserve System

The Federal Reserve system was established for the purpose of unifying the banking system and of giving leadership and supervision to it in the discharge of its functions in supplying and distributing credit. The intention was to make it strong where the old system was weak, to-wit: in an organized control which would protect the country from the errors and excesses of uninformed and ill-advised credit expansion.

The Reserve authorities, however, can perform their functions only through the banking system. Every dollar withdrawn from the administration of the banks and loaned outside of their direction weakens the authority, the policies and the resources of the Reserve system. It tends to throw the administration and distribution of credit back into the state of

semi-anarchy which existed before the Reserve system was established.

Legislation in matters of this kind is useless without the cooperation of the public. A highly organized people must be capable of self-government, or at least capable of understanding the intent of the laws which they pass for their own government, and be willing to conform to them.

The fact that it is accepted and acted upon by some of the country's most important corporations gives evidence that this is not a fanciful or impractical view. It is gratifying to be able to say that this cooperation is being given, on principle, by a list representing what may be called the very aristocracy of American industry, including the United States Steel Corporation, the American Telephone and Telegraph Company, the General Electric Company, the American Radiator Company, General Motors Corporation, the National Biscuit Company, all of whom we understand have consistently abstained from the call loan market. No doubt there are others, but this list is a host in itself. It sets an example of sound business policy, considerate of the general interests.

Wall Street Journal Comment

The Wall Street Journal is a source of information and comments relative to Wall Street conditions and tendencies which cannot be regarded as unfriendly to Stock Exchange activities, and the following extracts from a first page article (too long to quote in full) in its issue of January 25 is pertinent to the foregoing discussion:

But still another factor in credit volume must now be considered seriously, namely the use of non-bank funds in security market loans. Such funds do not enter the banking picture directly, but their importance indirectly as a potential call on bank credit was clearly demonstrated over the year-end. In December, "others" withdrew over $170,000,000 from the New York money market. To prevent demoralization of the market, New York banks had to supply the deficiency. Coming, as it did, at the end of the year, this placed a considerable burden on the credit situation.

If the increase in brokers' loans for the account of "others," as reported by the Federal Reserve Bank of New York, be added to the increase of brokers' loans made by private bankers, foreign agencies, etc., reported by the Stock Exchange, it will be seen that non-bank credit extended to security markets gained just short of $2,000,000,000 during 1928. If all this increase be added to the actual increase in credit extended by banks of the country, then the use of credit in this country last year will be found to have expanded at the rate of about 8 per cent.

Whether all non-bank loans on securities should be included in the credit picture that comes under surveillance of the Reserve Banks is highly debatable. However, it would seem to fall within the province of the Reserve Banks to pay attention to the tremendous increase in funds used for speculation, more particularly since, in addition to the already large amount of bank credit directly involved therein, there is a substantial volume of funds which is a potential call on bank credit.

* * * *

Unfortunately for Reserve Bank policy, the test of security prices by high interest rates cannot continue indefinitely without affecting business. The anomalous situation of abnormally high call and time money rates and relatively low commercial rates that prevailed through 1928 is apparently drawing to an end. The spread between the two broad types of loans is constantly narrowing, at the expense of business loan rates. In fact, business interest rates are now rising to levels where the 5 per cent rediscount rate is getting out of line. How high money can go before adversely affecting business can be determined only by trial, but the danger is not to be minimized.

High interest rates here already have exerted their normal influence on international credit conditions. Gold has started to flow in from England and sterling is at the gold import level. The question arises whether high interest rates can be maintained here without seriously embarrassing the Bank of England, which is in no position to lose gold in any quantity. Should the Federal Reserve increase its discount rate it is probable England's position would be even less secure than now. For the time being it would seem that the discount rate had been removed from the Reserve Banks' available instruments of policy.

Federal Reserve's problem boils down to finding a policy that will discourage a rate of increase in speculative loans out of keeping with the rate of the country's savings, and yet a policy that will neither hamper business, unsettle confidence, nor precipitate international credit disturbances. How this problem can be met seems beyond the ken of Wall Street's most experienced bankers.

The problem as stated in the last paragraph is clearly beyond the powers of the Reserve authorities or the member banks, unless they can have the cooperation of the business public.

Gold Movements

With the demand for credit both for speculative and business purposes continuing strong, and the Federal Reserve Banks pursuing a firm money policy, the one hope of easy money has appeared to lie in the possibilities of gold imports.

The point is made that the high money rates in this market not only of themselves attract funds, but by causing a falling off in foreign security sales here, are likely to result in a situation wherein gold will flow to this market in settlement of the balance of payments on merchandise trade and interest account.

Heaviness of the principal exchanges, and particularly of sterling, since the first of the year, together with a substantial inflow of gold from Canada and some movement from London, have given encouragement to this view.

Nevertheless, despite the existence of some circumstances favorable to gold imports, there is reason to doubt that the United States faces a gold movement of sufficient size to materially affect the credit situation.

For the year 1928 the country sustained a loss of $272,000,000 of gold through net exports and ear-markings, following a net loss of $154,000,000 in 1927.

For the month of January, 1929, imports have amounted to $48,568,000, not counting an additional $5,500,000 purchased in London but not due to arrive until February. More than offsetting this was $75,000,000 ear-marked here during the month for foreign account, presumably the Bank of France, so that the result of gold transactions was a further reduction of $26,432,000 in our gold stock since the end of 1928.

Of the total of $48,568,000 gold which has come in during January, $39,750,000 or 82 per cent has come from Canada. This is partly a seasonal movement which is familiar at this time of year, and may be considered temporary. Of the balance, practically the entire amount, or $7,500,000, has come from London, where an additional amount of $5,500,000 has been purchased for arrival early in February.

That Europe has any large surplus of gold available for shipment to the United States is doubtful. Gold reserves of the Bank of England have suffered a severe drain during the past six months, and it is unlikely that the Bank will permit much further loss without taking steps to protect itself.

The Bank of France has been endeavoring to build up its gold holdings, as evidenced by its ear-marking of gold in this market during the past three months. With French trade and industry facing a period of expansion, requirements for credit and currency are likely to be heavier, so that France will more probably require larger rather than smaller reserves.

Germany has been the principal gainer of gold in Europe during the past year, and on January 7 the Reichsbank held a reserve of gold and foreign exchange against notes in circulation of 64.4 per cent. Simultaneously with this inflow of gold and a slackening in the trade situation interest rates have shown an easier tendency. On January 12 the Reichsbanks' rediscount rate was reduced from 7 to 6½ per cent, and there is talk of the possibility of a further reduction in the near future. Nevertheless interest rates in Germany are still high as compared with the other principal money markets of the world, hence it is to be doubted that any important withdrawal of foreign investments or outflow of gold is imminent.

Spain, the only other European country with unusually large reserves, is endeavoring to get back to the gold standard, and is not likely to part willingly with any substantial part of its holdings.

While new gold coming on the market from South Africa would be available for shipment to the United States, to obtain it we would have to bid against all other buyers. Last year South African production amounted to £44,000,000 of which, however, but £29,249,000 went to the London market, most of the remainder being taken by India and shipped direct from South Africa. At this early date it is impossible to estimate what the demand from India and other Far Eastern markets will be.

That the course of interest rates in this country is being watched with anxiety abroad is evident from the comment in foreign financial publications. In these expressions of opinion one finds little support for the view that Europe can spare any important amount of gold to the United States. On the contrary, the feeling is general that such a movement must have the inevitable effect of forcing an advance of rates in foreign centers and placing a heavier burden upon industry.

The following paragraph from the January 5 number of the London Statist is illustrative of responsible foreign opinion as to what the continuance of high money rates means to the money markets and trade of the world:

> During the past five months, the Bank of England has fought a staunch and until now successful battle against the constant pull of monetary stringency in New York. This battle has taken its toll in the shape of gold, and the Bank begins the New Year with a gold reserve only £1 million higher than it was at the beginning of 1928. The power of resistance has been sapped, and unless monetary conditions in the United States relax appreciably the possibility of a higher Bank rate here must continue to be entertained. Such a movement would be an unfortunate reflection on the capacity of cooperative action on the part of the central banks of the world. It would probably force a number of Continental central banks to raise their rates of discount and would so affect the international credit situation as to make almost inevitable a further fall in the level of world prices. From such a movement the whole industrial world would suffer.

The Acceptance Situation

A significant feature of the money market during the past month has been the situation in the bill market where an interesting condition has arisen, marked by a rise in acceptance rates to a parity with the discount rate, an unusually large volume of acceptance holdings by the Reserve banks for this time of year, and some pressure by the Reserve banks to reduce these holdings.

The Federal Reserve Act first gave to American banks the authority to accept time bills of exchange. Since then the use of the acceptance in this country has been gradually extended until by this Fall the volume of bills outstanding reached a level exceeding $1,250,000,000, a figure approaching the total of bills estimated for the London market, notwithstanding the long familiarity of that market with this form of credit instrument.

With this growth in the use of dollar acceptances, the discount market has had ample opportunity for demonstrating its usefulness as a part of the American credit system.

It has enabled the American foreign trader to finance his business in dollars through American banks and without risk of exchange losses; it has provided a new and highly liquid form of temporary investment of maximum security; and it has brought to American banks the opportunity of participating more directly and importantly in financing the overseas trade of the world, and all of the advantages arising from the closer foreign connections resulting therefrom.

Another important service of the bill market has been to provide help in supplying the extra funds needed in the Fall of the year to

finance the crop moving and the holiday trade. At such times there is always an increased demand for currency, which, if supplied entirely through member bank borrowing, would involve considerable credit strain. Through the purchase by the Reserve banks, however, of bills which are always drawn more freely in the Fall to finance seasonal commodity shipments, Reserve credit is put into the market at a time when needed and seasonal strain averted.

The Experience Last Autumn

For a practical demonstration of this we have only to look back to the experience of last Autumn. In the January issue of this Letter we quoted several paragraphs from an address by Dr. W. R. Burgess, Assistant Federal Reserve Agent of the Federal Reserve Bank of New York, before the December annual meeting of the American Acceptance Council, in which the speaker discussed the Fall situation in a manner so pertinent that we reproduce his remarks once again.

In August and September money rates were decidedly firm, but instead of growing firmer still as the autumn advanced they eased slightly in October and November. Between August and November there was an increase in the requirement for Federal Reserve credit for currency and bank reserves amounting to about 200 million dollars, but this increase in demand had no effect upon money conditions because the acceptance holdings of the Reserve Banks were increased by about 300 million dollars. Because of a large volume of bills in the market and the high level of money rates, together with considerable liquidation of bills by foreign banks of issue, this large amount of acceptances found its way into the Federal Reserve Banks. The net result was that the money market gained funds instead of losing, and money rates instead of becoming firmer became temporarily slightly easier.

Purchases of bills by the Reserve Banks were exceptionally large this year, for the reasons indicated. Ordinarily bill purchases are less than the total increase in requirements for Federal Reserve credit and member bank borrowings are increased 50 to 75 million dollars over this period. The increase in bill holdings is usually just sufficient to prevent any considerable firming in money conditions, and thus ordinarily acts as an important stabilizing force in the money market at the period when crops are being moved and holiday trade is getting under way.

Thus it was that by the help of the bill market what otherwise gave every promise of being a very tight situation was taken care of without strain.

Limitations of the Bill Market

The trouble with the bill market is that it has never been able to stand completely on its own feet. Rates have had to be low enough to compete with those of foreign centers where the discount market is the principal medium of temporary investment, and much of the time this has meant rates lower than could be had on other forms of investment in this market. As a consequence, the bill market in this country has been lacking in breadth, and has been too dependent on the Federal Reserve banks. Discussing this phase of the acceptance situation before the December meeting of the Acceptance Council, Howard J. Sachs, President of the Council, said in part:

On Nov. 28, the bill holdings of the System for its own account and for foreign account amounted to $750,000,000 or nearly three-quarters of the total amount of acceptances outstanding, and the bills owned by discount houses amounted to at least $25,-000,000. The balance was held by banks for their own account and foreign accounts by individuals and by corporations, and while it is not possible to analyze this amount further, it is significant that according to the reports furnished to the American Acceptance Council by the leading acceptance banks of this country their holdings of bills for their own account on Oct. 31 was $21,000,000. Even without more accurate figures, it would appear quite certain that there is no general tendency on the part of banking institutions in this country to carry bills as part of their reserves.

This dependence of the bill market upon the Reserve banks has the bad feature of sometimes resulting in a conflict between the needs of the bill market and the Reserve System's general credit policy. Such was the case last Autumn when the Reserve banks, in order to assist the country through the crop moving period, made difficult by unusually high money rates and a record amount of bank credit supplied through bills, had to buy heavily of acceptances and in so doing put excess credit into the market at a time when their general credit policy was directed towards holding money firm.

Dr. Burgess in the address already referred to discussed this situation very candidly, and voiced the Reserve System's dissatisfaction with it in the following words:

The citing of this year's experience in the bill purchases of the Reserve Bank compels us in candor to discuss one less satisfactory feature of the present development of the bill market in this country, for the experience this autumn illustrates the truth, which I think all students of the market recognize that the American bill market is too dependent upon the Federal Reserve System. The investment demand for bills is so small that at times the Reserve System finds itself in the dilemma of either starving out the bill market or putting more of its funds into the money market than other aspects of credit policy would suggest. This autumn the volume of bills created has been larger than ever before.

At the present level of money rates almost the only demand for these bills has been from foreign buyers. If the Reserve Banks had not been willing to follow their usual policy of taking at their buying rate the surplus of bills offered to them, the dealers would been forced either to refuse to purchase new bills at all, or at rates so high as to be prohibitive. On the other hand, the taking by the Reserve Bank of bills offered involved putting into the money market something like 100 million dollars more than seasonal credit needs required, which was used by member banks to liquidate a part of their indebtedness, and thus tended, in conjunction with gold imports, to ease slightly the money situation. Early this autumn the Reserve System faced the dilemma of either starving out the bill market or else giving such substantial support as would tend to ease the money market. The System decided in favor of continuing to take bills rather freely. I think it is a reasonable interpretation of motive to say that this decision was influenced by the desire to assure an adequate supply of funds at reasonable rates for the autumn requirements of business and agriculture.

But the American acceptance market cannot be considered in a permanently satisfactory position while it is so largely dependent upon the Reserve Banks. In saying this, I recognize that the acceptance market in any country is dependent on the bank of issue in emergencies. But the market in this country is in a

different position from that of other countries in depending so largely upon the bank of issue for its regular supply of funds.

The Advance in Bill Rates

With the crop moving demand largely over in December, the Reserve banks, aware that the funds which they were releasing to the market were causing an undue ease, began to take steps to reduce their large bill holdings and to force the market to carry a more important share of the bills outstanding. It was reported that the Reserve banks were buying less freely and were following a policy, so far as practicable, of confining their purchases to bills which had run a part of their term and consequently had been carried on the market for a time before being offered to the Reserve bank. The effect of this policy was manifest in a firmer tone in the money market and on December 14 dealers advanced their buying rates for 90-day bills from 4⅝ to 4¾ per cent.

During January the Reserve banks continued their efforts to reduce their bill portfolios, and open market rates in consequence underwent a succession of advances, finally closing the month at a level of 5⅛ per cent bid and 5 per cent asked for 90-day maturities. During the same period the Reserve bank, in accordance with its practice of following the market, advanced its buying rate from 4½ to 5 per cent.

None of these advances, however, accomplished any material results towards broadening the distribution of bills until the last, when a somewhat better demand was manifest, and in the week of January 23 the Reserve banks were enabled to effect the first substantial reduction in their holdings since last Fall.

Significance of Higher Rates

The foregoing developments in the bill market have attracted a large amount of attention, and the financial community generally is giving unusual study to their significance.

The fact that in the past a rise in the bill rate to the re-discount rate usually has been the forerunner of an advance in the latter has occasioned some discussion as to the possibility of this occurring at the present time. There is no hard and fast reason, however, why the two rates should always move in unison. With the volume of member bank borrowing sharply reduced since the peak, and no disposition on the part of banks to unduly increase their own loans in the speculative markets, there seems no immediate call for a higher bank rate, at least in this district.

What the final outcome will be to the bill market of these efforts looking towards a broader distribution of bills is a matter for conjecture. So long as our market is constituted as at present, with its heavy concentration of funds in Stock Exchange loans, it is a serious problem as to whether rates high enough to effect the desired distribution of acceptances may not cause a shifting of customers' requirements to some other markets or to some other form of accommodation than bills. For the month of December, at least, there was no evidence that such a shift has been taking place, the report of the American Acceptance Council showing an increase during the month of $84,130,000 in bankers acceptances outstanding to a new high record of $1,284,485,780.

Whatever the final outcome, however, the immediate influence of policies now in force is in the direction of firm money conditions. As Federal Reserve purchases are reduced, bills have to be carried in larger volume on the market, and this absorbs funds and tends to keep money tight.

The British and United States Currencies

The changes in the currency system of Great Britain which have been accomplished by the legislation of the past year are of interest in this country, not only because of the highly important position which the Bank of England holds in international finance, but because the problem of consolidating the outstanding Treasury currency with Bank of England issues is very similar to that which is pending in this country in the plan to have the Federal Reserve banks take over the national bank issues and eventually the United States legal tenders and the gold and silver certificates.

Before the war, the Bank of England under its constitution issued currency notes only against equal holdings of gold, with the exception of a fiduciary issue fixed at £19,750,000, which was covered by Government securities. For the benefit of readers not familiar with banking terms the explanation may be made that by common usage the word "fiduciary" in this connection refers to currency issues against trust funds dedicated to their ultimate redemption, but usually of a permanent character, as Government bonds, instead of gold and ordinary banking assets.

Thus the system differed from those in which the bank of issue is authorized to vary the volume of currency outstanding, subject to the condition that it must keep a minimum percentage of gold in reserve, as in the case of the Federal Reserve banks, the Bank of France and nearly all other central banks. The monetary stock could be expanded only by imports of gold and was necessarily contracted by any loss of gold from the Bank's reserve. The system was uncomfortably rigid at times, for on several occasions since the adoption of the system in 1844, extraordinary demands upon the banking department for the conversion of deposits into cash brought the great

institution, although perfectly solvent, almost to the point of suspending payments. Each time, however, the crisis was met by action of the Government, through the cabinet, authorizing the Bank to issue additional notes without compliance with the reserve requirement, with the assurance that Parliament would be asked to pass an act condoning the violation of law. That the confidence of the public in the Bank was unimpaired is evident from the fact that its notes were readily accepted on these occasions, and each time a panic in the money market was quieted by the Bank's increased ability to make loans and supply currency. The situation upon these occasions was similar to that in this country in 1907, when solvent banks were unable to meet demands upon them, simply by reason of inelasticity of the currency.

The Treasury Currency

When the Great War broke out, the Bank was promptly authorized and required to suspend gold payments, on account of the national emergency, but it never had issued notes of less than the £5 denomination (approximately $25) and it was necessary to provide paper currency in smaller denominations to take the place of the gold and silver coins which had been in circulation. Moreover, the enormous increase in the country's currency requirements made it appropriate that the Government should assume responsibility in the situation. The Treasury notes, which were issued in £1 and ten shilling denominations, have been in circulation since.

In the fore part of 1928, legislation was passed providing for the retirement of these notes and the substitution of Bank of England notes. The Government undertook to reimburse the Bank by transferring to it the cash and Government securities which were held in the issue department of the Treasury. The Bank will retire the Treasury notes as they are gradually received, and hereafter will issue £1 and 10 shilling notes as wanted, there being no intention of restoring gold coin to circulation. The act resuming gold payments requires the Bank to redeem its notes in fine gold bars of 400 ounces weight, but not in coin. The Bank obliges itself to pay over to the Treasury the net profits realized on this addition to the volume of its note issues.

On November 21, the date of the last statement before amalgamation went into effect, Treasury notes outstanding aggregated £286,-750,498, against which the Treasury held £56,250,000 of Bank of England notes as reserve, hence the net increase in the Bank issues by reason of the amalgamation, would be £230,500,498, equal approximately to $1,123,-000,000. The chief problem was what to do about a reserve against this great increase of demand liabilities.

The decision was that the Bank should be permitted to raise the fiduciary issue to £260,-000,000, or the equivalent of a little less than $1,300,000,000, including therein the £19,750,-000 of its own fiduciary notes already outstanding, all of which may be fully covered by securities instead of gold. The net Treasury issue on the day of amalgamation and the £19,750,000, apparently make a total for the fiduciary issue immediately outstanding of £250,250,498 or £9,749,502 less than the amount now authorized. The avowed intent of the Government authorities in fixing the amount at £260,000,000 was to accomplish the transfer of the Treasury issues to the Bank without requiring any contraction of the present volume of currency or any increase of the Bank's gold reserve.

A Provision on Additional Note Issues

A degree of elasticity is imparted to the fiduciary issue by the following provisions of the law:

> The Treasury may at any time on being requested by the Bank, direct that the amount of the fiduciary note issue shall for such period as may be determined by the Treasury, after consultation with the Bank, be reduced by such amount as may be so determined.
>
> If the Bank at any time represent to the Treasury that it is expedient that the amount of the fiduciary note issue shall be increased to some specified amount above two hundred and sixty million pounds, the Treasury may authorize the Bank to issue bank notes to such an amount, not exceeding the amount specified as aforesaid, and for such period, not exceeding six months, as the Treasury think proper.
>
> Any authority so given may be renewed or varied from time to time on the like representation and in like manner: provided, that, notwithstanding the foregoing provision, no such authority shall be renewed so as to remain in force (whether with or without variation) after the expiration of a period of two years from the date on which it was originally given, unless Parliament otherwise determines.

The fiduciary issue of course, always is outstanding in full, so far as the issue department is concerned, although a portion of the notes always is held in the banking department, constituting its reserves. The issue and banking departments are run like separate institutions, as is practically the case of the banking and issue departments of our Federal Reserve banks.

The weekly statement of the Bank of England, however, is for the banking department only, not including the issue department, and the reserve percentage shown is the percentage of coin and its own bank notes in the banking department against deposits. On the other hand, the weekly statement of the Federal Reserve banks includes both departments, but Reserve notes are not counted as a liability or resource of the issuing bank unless actually in circulation outside of the bank.

At the date of the statement as of December 26, 1928, the gold reserve of the issue department of the Bank of England was £153,783,646, against which an equal amount

of notes had been issued, and together with the fiduciary note issue the aggregate of outstanding notes, therefore, was £413,783,646.

It will be seen that the fluctuations in the volume of currency will still occur, as before the war, in the notes issued against equal amounts of gold, except as modified by the provisions relative to the fiduciary issue which are quoted above.

These modifications constitute a concession by the Ministry and the Parliament to proposals which have had a considerable body of support, that the system should be changed to one more like the Federal Reserve system and other central banking institutions whose note issues are regulated by minimum reserve percentages. The latter plan is more elastic, but the Bank of England system opposes the most uncompromising front to currency inflation.

Currency and Deposits

This legislation reflects the conservatism of British financiers on the subject of the currency, and presents an interesting question. On this side of the water the first thought is that the policy exaggerates the danger of inflation by means of the currency in comparison with the same danger through book credits, or, in other words, the same danger by the manufacture of deposits through loans. In Great Britain, as in this country, currency has been largely relegated to a comparatively subordinate service, in retail transactions, making its issue and retirement in the main automatic. Thus in itself, it is scarcely subject to inflation, and regulation seems more likely to hamper business than protect it. The great bulk of the business is done by means of the deposit currency, which under the Bank of England system is without direct regulation. In the United States the Reserve banks must maintain minimum reserves not only against note issues but against deposits, and the member banks of the system must maintain minimum reserves (in the Reserve banks) against deposits. Under the British system neither the Bank of England nor the joint stock banks are under any legal requirement to maintain fixed reserves against deposits. It should be understood that British banks are private corporations, not subject to Government inspection, examination or control. All, however, are members of the British Bankers Association, whereby in matters of general public policy they work in concert, under the leadership of the Bank of England.

This seems a little like guarding the spigot and allowing freedom at the bung, but such a conclusion does not give due weight to the argument that the fundamental thing is to maintain the integrity of the money. If there is to be inflation somewhere, the last place to have it is in the currency. Also, if there is always danger of inflation in deposits it is all the more important that there shall be no chance of it in the currency.

So far as economy of gold is concerned, it can be had under the British system, by means of the fiduciary issue, which may be as large as the authorities see fit to make it. The system is based upon the theory that under no circumstances will there ever be a call for redemption in gold of any portion of the fiduciary issue.

In the first place, it is believed that no important demand for redemption on account of apprehensions as to the solvency of the Bank ever will occur. The Bank is so much of a public institution that the credit of the Government surely would be placed behind it if ever there should be need for such action; in the second place, there is a limit below which it is practically impossible to reduce the volume of a country's currency, because it is required in the transaction of current business. The volume now fixed for the fiduciary issue of Great Britain is calculated to be below the minimum amount which can be reached in that country. The new system has started off with £260,000,000 of fiduciary issue and £162,000,000 of notes backed by an equal amount of gold, or a ratio against all notes of 38.4 per cent. In view of the relations of a central bank to the money market it is safe to say that any considerable encroachment upon this reserve would involve a general restriction of credit which would bring the movement to an end.

The first statement of the Bank after the amalgamation showed that the fiduciary issue of £260,000,000 was backed by £244,583,650 of British Government securities and £10,176,193 of "other securities," with silver coin to balance. The silver is an old holding and probably will disappear. Thus it will be seen that Government credit already is behind all but an insignificant part of that portion of the currency which is not fully covered by gold.

Our National Bank Currency

It has been said at the beginning of this article that the problem of amalgamating the two currency systems which Great Britain has had since 1914 was analogous to the problem which has been presented to this country by the plan contemplated in the Federal Reserve Act, of eventually consolidating our several forms of paper currency with the Federal Reserve currency.

The several elements in the paper currency of the United States, and the amounts of each outstanding on the 1st day of December, 1928, are given herewith:

United States legal tender notes	$ 346,681,016
United States gold certificates	1,401,509,049
United States Silver certificates	466,966,396
Federal Reserve notes	2,140,842,965
Federal Reserve bank notes	3,949,861
National Bank notes	700,180,759
Treasury notes of 1890	1,294,850

The several kinds of currency were authorized at different times, by piece-meal legislation, without thought of a unified and comprehensive system.

The United States legal tender notes were originally issued during the Civil War, the acts authorizing them being regarded at the time as necessary but temporary measures to enable the Treasury to meet the extraordinary demands upon it at that time. Their issue produced an artificial inflation of credit, and it became politically impracticable to retire them.

The national banking system was established in 1863 to provide a national system of bank currency to take the place of the currency issued by State banks, much of which was unsecured, unregulated, and subject to discount outside of the localities in which these numerous banks were located. The National banks were required to fully cover their currency issues by deposits of United States Government bonds in the custody of the Treasurer, at Washington, D. C. Member banks of the system might and did fail, but no holder of national bank notes ever has lost a dollar. The currency system, however, lacked the elasticity which is now supplied by the Federal Reserve system.

The gold certificates were authorized for the convenience of the public, which had become accustomed to the use of paper money during the suspension of specie payments from 1862 to 1879 and did not want to go back to the actual handling of coin, except for pocket change. They are simply Treasury receipts for equal amounts of gold, bullion or coin. Silver certificates are Treasury receipts for equal amounts of silver dollars.

Treasury notes of 1890 were originally issued to pay for silver bullion purchased under the silver purchase act of 1890, which represented an effort on the part of the United States to maintain the old system of Bimetalism, by holding the two metals at fixed relations to each other and using both as standard money. The effort was a failure, but the silver certificates and Treasury notes of 1890 remain as mementos of it.

The Federal Reserve bank notes which are outstanding (distinguished from Federal Reserve notes) were issued under the Pittman Act during the late war, in place of silver certificates which were retired for the purpose of releasing silver dollars which were melted down for the purpose of settling the trade balance in favor of India, which could not be settled in any other way. Great Britain paid for the silver dollars and the United States Government afterward bought silver to replace them, and silver certificates have replaced most of the Federal Reserve notes, but this residue of them remains outstanding. Under the terms of the Pittman Act, these notes were secured by deposit of interest-bearing United States Government obligations.

The Plan of Unification

It was in the minds of the authors of the Federal Reserve Act that all of this heterogeneous array of currencies should be eventually replaced by the issues of the Reserve banks, but they made provision only for replacement of the national bank notes. The plan for the retirement contemplated that the Federal Reserve banks should gradually take over by purchase the Government bonds now pledged, and retire the national bank notes by issuing their own notes, and that the Government would either pay off the two per cents out of surplus revenues or take them off the hands of the Reserve banks by issuing three per cents instead, all to be accomplished at the rate of about $25,000,000 per year.

The war interfered with this program, because three per cent bonds could not be sold at par. Since the decline of interest rates on Government bonds, consideration has been given to resumption of the plan, but doubts have developed as to the wisdom of doing so, at least at present. The present volume of national bank notes constitutes a perfectly sound and secure form of currency. They are a "fiduciary" currency, identical with that which the Bank of England has just been authorized to issue to a largely increased amount, except that no security but Government bonds is permitted and the security is deposited in the hands of the United States Treasurer as trustee, instead of being in the possession of the issuing bank. Furthermore, it may be considered an advantage that these issues are not a liability of the Reserve banks, since they do not affect their reserve percentages. If the $700,000,000 of National bank notes outstanding on November 30, 1928, had been additional Federal Reserve notes, the reserve percentage in the consolidated statement would have been 53 per cent, instead of 62.3 per cent.

It is true that every element in the currency, in a sense, is a charge on the gold reserve, whether in terms redeemable in gold or not, because it contributes to fix the volume point at which the demand for gold will arise; hence, it may be said that if national bank notes were replaced by Federal Reserve notes the pressure on the gold reserves would not be increased; but in order to have the capacity for future expansion which exists now it would be necessary to lower the present reserve requirement. Such action might not be generally understood or easily obtained. The immediate effect of the substitution would be to reduce the surplus reserves as indicated above.

The following bonds carrying the circulation privilege are outstanding:

	Amount outstanding Oct. 31, 1924	Amount pledged with Treasurer to secure circulation, Nov. 1, 1924
2% consols of 1930	$599,724,050	$589,086,200
2% Panama Canal loan, 1916-36	48,954,180	48,484,720
2% Panama Canal loan, 1918-38	25,947,400	25,584,920
Total	$674,625,630	$663,155,840

It will be seen that all but $11,469,790 of these bonds are pledged for circulation. Although the consols are payable in 1930 they have no due date and may run at the pleasure of the Treasury. In view of the volume of bonds outstanding drawing higher rates of interest, retirement of the 2 per cents would involve the continued payment of higher rates on other indebtedness. However, it has been pointed out that the substitution of Federal Reserve notes for national bank notes probably would increase the surplus earnings of the Reserve banks, which go to the Treasury.

Objections Considered

The great fault of the national bank currency, considered by itself, was that it lacked elasticity. Moreover, silver certificates and United States legal tenders were without elasticity and gold certificates had but little. Federal Reserves notes, however, now provide this requisite for the entire system, and as the authority to issue them is unlimited, subject only to the reserve requirements, the replacement of national bank notes by reserve notes would add nothing to elasticity. On the contrary, it would limit the possible expansion of Reserve credit to that extent, unless the reserve requirement was lowered.

The case would be different if the amount of paper currency directly payable in gold was not ample to afford the public ready means of obtaining the metal for all purposes. The Federal Reserve notes, United States legal tender and gold certificates are directly redeemable in gold and provide sufficient means of access to the gold reserve. In fact, all of our currency is interchangeable.

It is inconceivable that any "run" on either the Reserve banks or National banks for redemption of their notes in gold for hoarding purposes ever will occur, in view of the fact that Reserve notes actually are promises of the United States Government and National bank notes are secured dollar for dollar by Government bonds. It is inconceivable also that the amount of currency in circulation ever could be reduced so low that there would not exist an ample supply of the kinds directly redeemable in gold.

If all the other forms of paper currency excepting National bank notes were replaced by Federal Reserve notes, and the gold now in the Treasury as reserves against gold certificates and United States legal tenders, was turned over to the Reserve banks, the percentage of the latter's gold reserves would be slightly increased. Therefore, so far as these issues are concerned, no objection to unification of the currency for the reason we are now considering, can be made.

A unified currency in itself is desirable, as more rational and orderly than the present multiplication of forms, the reasons for which have passed away, but there is a rational argument for retaining the National banking system, including the currency.

The National banks would lose the note-issuing privilege with reluctance, for they value the distinction which the notes carry, and there is a net profit of approximately 1½ per cent upon the circulation, reckoning the bonds at par, the value which the banks would receive for them. The National banks are intimately identified with the Federal Reserve system, and there is a valid reason for recognizing that relationship by maintenance of the present fiduciary issues.

The only objection that can be conceived of would arise if agitation should develop for increasing the volume of such issues. That might become a contentious subject, for under no circumstances should National bank issues be allowed to impair an effective control over the volume of the currency by the Federal Reserve authorities.

Position of the Treasury

The Secretary of the Treasury has addressed the following communication bearing upon the subject of the foregoing discussion:

THE SECRETARY OF THE TREASURY
Washington, January 21, 1929.

My dear Mr. President (Speaker):

In my Annual Report for the fiscal year 1928, submitted to the Congress last December, referring to the question of whether the National Bank notes now in circulation should be retired, I said as follows:

"In all probability a conclusion as to the possible retirement of the national-bank circulation, through exercise of the call privilege attaching to the 2 per cent consols which arises after April 1, 1930, will be reached before the department can issue national-bank notes in the reduced size. The Federal Reserve Act originally contemplated the retirement of the national-bank currency. The problem was discussed fully in the annual report for 1924. Considerable time having elapsed, it is felt advisable to submit the matter to the Congress for decision at the present session. In the event national-bank notes are continued indefinitely as a part of the money circulation of the United States, the Treasury will be prepared to apply the new designs to such notes and to make them available in the reduced size within a reasonable time after the issue of other kinds of currency in the reduced size."

The question has received the thorough study and consideration of this department, and I have concluded that it would be inadvisable to submit to Congress at this time a program looking to early retirement of our National Bank note circulation. Accordingly, when the new-size paper currency is issued, on or about July 1, 1929, the Treasury Department will be prepared shortly thereafter to make available National Bank notes in the reduced size.

Sincerely yours,
A. W. MELLON,
Secretary of the Treasury.

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